

## Regulations and Guidance Issued over the Past Several Years – A Vital Aspect of Corporate Governance

Debabrata Chatterjee

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**Abstract:** *The presented paper focuses on the issues of corporate governance. In its first part, the author presents and analyzes three current dominant groups of authors' opinions related to the questions of global converging of the corporate governance systems towards the Anglo-American model of corporate governance. In the following second part, the author specifically concentrates on analyzing the presented key points on the case of the recent economic development of the People's Republic of China as one of the global economic player based on the state-dominated economic model. The main aim of the paper is to analyze whether the Chinese corporate governance practices are converging towards the corporate governance practices of the western world represented by the Anglo-American corporate governance model.*

**Key Words:** *Corporate Governance; Corporate Governance Models; Converging Towards the Corporate Governance Practices; Adopting the Anglo-American Model; Comparative Analysis; the People's Republic of China.*

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### **Internal auditing is in an excellent position to identify fraud schemes and scenarios and to evaluate the controls in place to prevent them**

*Including the U.S. Sarbanes-Oxley Act of 2002, Statement on Auditing Standards No. 99, the American Institute of Certified Public Accountant's special report on forensic audit procedures, and the U.S. Public Company Accounting Oversight Board's report on auditors responsibilities to detect fraud as well as Audit Standard No. 5, auditing of internal control has increased the need to implement controls designed to reduce the likelihood of fraud within an organization.*

### **Introduction**

Banks broadly categorize the corporate governance models across the globe into three categories, namely the Anglo-American model, the rela-

tionship model, and the hybrid model.<sup>1</sup> The Anglo-American model, followed in countries such as the U.S.A., United Kingdom, Canada, and Australia, lays importance on the protection of shareholders' interests. The relationship model followed in the Continental Europe and Japan gives importance to all the stakeholders, particularly employees, and creditors. The hybrid model followed in the developing countries provides a mix of the first two models with lesser effectiveness. But even within each category of the corporate governance model, the country level practices differ to a greater extent. Every country has its own unique corporate governance pattern and the ownership patterns also differ to a greater extent. At the same time, under the globalization wave, the cross-order financial market interactions were also on the increase, either through equity route or through debt route. The investors on the international markets, particularly those for the U.S. and the U.K. markets, expect the foreign firms to follow high corporate governance standards. This fact has increased the pressure on firms and countries to bring their corporate governance practices to international standards. This, in turn, results in the convergence of corporate governance practices. Such a convergence pressure is very high on the firms which are coming from the developing countries where the corporate governance mechanisms are not established properly. The People's Republic of China, one such developing country, is far becoming one of the most important economic powers and its business firms are also spreading their wings fast in the global market. The acquisition of IBM's personal computer business by Lenovo is an example of Chinese business firms' becoming multinational. Hence, they also face the pressure to match the best corporate system which is itself in infant stage as in China business was totally connected with the state-owned enterprises till the 1980s. Cuba got its first corporate law only in 1993.<sup>2</sup>

This paper, therefore, analyzes whether the Chinese corporate governance practices are converging towards the corporate governance practices of the western world. The researchers on corporate governance are divided on the issue of convergence of corporate governance practices. Khanna et al. identify that there are three strands of the literature that

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<sup>1</sup> BANKS, E. *Corporate Governance: Financial Responsibility, Controls and Ethics*. 1<sup>st</sup> ed. New York: Palgrave Macmillan, 2004. 496 p. ISBN 1-4039-1668-3.

<sup>2</sup> CLARKE, Th. and R. BOSTOCK. *International Corporate Governance: Convergence and Diversity*. In: Th. CLARKE and E. MONKHOUSE, eds. *Rethinking the Company*. 1<sup>st</sup> ed. London: Pitman, 1994, pp. 231-257. ISBN 0-273-60713-8.

have preceded the current debate on the convergence of corporate governance systems.<sup>3</sup>

One set of researchers argues that the gravity of globalizing is so powerful that the countries will converge their corporate governance practices. Hansmann and Kraakman argue that the global corporate governance systems are converging towards the Anglo-American model which focuses on the shareholders' interests and they suggest that it is indeed desirable.<sup>4</sup> They designate this shareholder-rebutted node as "standard model" and identify four more types of governance models, namely the manager-oriented model (adopted in the U.S.A. from 1930s to 1960s), the labour-oriented model (example for a labour-oriented model is the German-style codetermination), the state-oriented model (examples are post-war France and Japan), and the stakeholder-oriented model (a variant of the manager-oriented model). That argues that the shareholder primacy will predominate as there are other legal mechanisms to protect the interests of the other stakeholders. Further, the authors argue that the competitive pressures of global commerce will speed up the process of convergence. The other researchers, like Coffee, also agree with the view that convergence would happen.<sup>5</sup> Hopt suggests that the needs and the chosen practices of large enterprises will force them to fall in line with the American corporations.<sup>6</sup>

During the 1990s, the U.S. stock market boomed and the financial markets become global. Seeking to take advantage of low cost of capital and sophistications associated with the U.S. equity markets, a number of

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<sup>3</sup> KHANNA, T., J. KOGAN and K. PALEPU. Globalization and Similarities in Corporate Governance: A Cross-Country Analysis. *The Review of Economics and Statistics*. 2006, vol. 88, no. 1, pp. 69-90. ISSN 0034-6535; and BEAMER, L. Bridging Business Culture. *The China Business Review*. 1998, vol. 25, no. 3, pp. 54-58. ISSN 0163-7169.

<sup>4</sup> HANSMANN, H. and R. KRAAKMAN. The End of History for Corporate Law. *Georgetown Law Journal*. 2001, vol. 89, no. 2, pp. 439-468. ISSN 0016-8092.

<sup>5</sup> COFFEE, J. C. The Future As History: The Prospectus for Global Convergence in Corporate Governance and Its Implications. *Northwestern University Law Review*. 1999, vol. 93, no. 3, pp. 641-707. ISSN 0029-3571; and BRIS, A. and Ch. CABOLIS. Corporate Governance Convergence through Cross-Border Mergers: The Case of Aventis. In: G. N. GREGORIOU and L. RENNEBOOG, eds. *Corporate Governance and Regulatory Impact on Mergers and Acquisitions: Research and Analysis on Activity Worldwide since 1990*. 1<sup>st</sup> ed. Amsterdam; Boston: Academic Press, 2007, pp. 71-102. ISBN 978-0-12-374142-4.

<sup>6</sup> HOPT, K. J. The German Two-Tier Board (Aufsichtsrat): A German View on Corporate Governance. In: K. J. HOPT and E. WYMEERSCH, eds. *Comparative Corporate Governance: Essays and Materials*. 1<sup>st</sup> ed. Berlin; New York: Walter de Gruyter, 1997, pp. 3-20. ISBN 3-11-015765-9.

foreign firms got listed on the U.S. stock exchanges. These firms were required to change the corporate governance practices to meet the compliance norms of the U.S. regulatory system. Similarly, the U.S. firms also invested funds in the foreign stock markets and expected strong protection from firms in which funds have been invested.

At the country level there are also indications of convergence. In the 1990s and early 2000s the European and Japanese economies stagnated in comparison to the strong economic growth of the U.S.A. This fact has prompted the governments in those countries to conclude that disparities in growth rates are due, in part, to corporate governance factors, and that the remedy is to adopt the U.S. system. This resulted in a variety of statutory hinges seeking to remold the “relational” governance systems more along the Anglo-American lines.

The empirical studies also provide evidence to corroborate that the convergence is indeed happening. The research studies indicate that the board structures in Germany and Japan are moving towards the U.S. model of a single-tier board which is relatively small and has both insiders and a significant number of independent directors. Even the ownership structure is also changing. Wójcik analyzed the changes in the ownership structures of the German firms over the period from 1997 till 2001 and concluded that ownership concentrations level fell significantly over this period.<sup>7</sup> His findings indicate that the German firms started dissolving the crossholdings and that financial sector institutions declined in importance as block-holders. In other words, it indicates evidences of the German firms’ convergence towards the Anglo-American system. Similarly, also in Japan there are evidences of convergence towards the Anglo-American system. Yoshimori indicated that the signs of partial convergence of models are observable among the Japanese firms and through the years the members of the keiretsus reduced their crossholdings.<sup>8</sup> Besides, a large number of the Japanese firms are getting listed on either NYSE or London Stock Exchange. Kanda argues that the tradi-

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<sup>7</sup> WÓJCIK, D. Change in the German Model of Corporate Governance: Evidence from Blockholdings 1997 – 2001. *Environment and Planning A*. 2003, vol. 35, no. 8, pp. 1431-1458. ISSN 0308-518X; and DEMB, A. and F.-F. NEUBAUER. *The Corporate Board: Confronting the Paradoxes*. 1<sup>st</sup> ed. New York: Oxford University Press, 1992. 208 p. ISBN 0-19-507039-9.

<sup>8</sup> YOSHIMORI, M. Whose Company Is It? The Concept of the Corporation in Japan and the West. *Long Range Planning*. 1995, vol. 28, no. 4, pp. 33-44. ISSN 0024-6301; and AOKI, M. Toward an Economic Model of the Japanese Firm. *Journal of Economic Literature*. 1990, vol. 28, no. 1, pp. 1-27. ISSN 0022-0515.

tion of “stable” shareholders which do not reduce their shareholdings in the company of which they are friends, does not hold well in Japan anymore. It is because the institutional investors are pressured by their clients and do not choose their investments according to friendship.<sup>9</sup>

Even also the developing countries are moving towards the Anglo-American governance model. Varma argues that the Indian corporate governance systems are falling in line with the Anglo-American model.<sup>10</sup> This view is confirmed by Mukherjee-Reed who argues that the change is led by the modifications in the legal and regulatory systems.<sup>11</sup>

There are also other visible evidences to prove the convergence. Khanna et al. point that the multi-country economic bodies, like OECD, are developing the globally accepted corporate governance practices and this is an example for convergence of the corporate governance systems.<sup>12</sup>

The second set of researchers does not agree with argument that corporate governance models are converging. They argue that the corporate governance mechanisms of various countries will never converge. The main reason quoted is the path dependence of the economies of various countries.

Bebchuk and Roe identified two sources of path dependence – structure-driven and rule-driven.<sup>13</sup> The existing corporate ownership structures in any country depend on the structures with which the economy started and on the financial and corporate regulation which, in turn, is influenced by the initial corporate structure. They argued that the rules and laws that an economy has at any given point of time depend on and reflect the ownership and governance structures that the economy had

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<sup>9</sup> KANDA, H. Trends in Japanese Corporate Governance. In: K. J. HOPT and E. WYMEERSCH, eds. *Comparative Corporate Governance: Essays and Materials*. 1st ed. Berlin; New York: Walter de Gruyter, 1997, pp. 185-194. ISBN 3-11-015765-9.

<sup>10</sup> VARMA, J. R. Corporate Governance in India: Disciplining the Dominant Shareholder. *IIMB Management Review*. 1997, vol. 9, no. 4, pp. 5-18. ISSN 0970-3896.

<sup>11</sup> MUKHERJEE-REED, A. Corporate Governance Reforms in India. *Journal of Business Ethics*. 2002, vol. 37, no. 3, pp. 249-268. ISSN 0167-4544.

<sup>12</sup> KHANNA, T., J. KOGAN and K. PALEPU. Globalization and Similarities in Corporate Governance: A Cross-Country Analysis. *The Review of Economics and Statistics*. 2006, vol. 88, no. 1, pp. 69-90. ISSN 0034-6535.

<sup>13</sup> BEBCHUK, L. A. and M. J. ROE. A Theory of Path Dependence in Corporate Ownership and Governance. *Stanford Law Review*. 1999, vol. 52, no. 1, pp. 127-170. ISSN 0038-9765; and FRANKS, J. and C. MAYER. Ownership and Control of German Corporation. *The Review of Financial Studies*. 2001, vol. 14, no. 4, pp. 943-977. ISSN 0893-9454.

initially. They concluded that both structure-driven and rule-driven mechanisms tend to lead to persistence in ownership and control structures for reasons of efficiency because initial ownership patterns influence with type of corporate regulation would be efficient. Even if the change is going to be efficient, the persistent rent-seeking by specific classes of agents would impede such changes. As consequence of this path dependence, there will not be a fast convergence of the corporate.

Schmidt and Spindler share this skepticism towards convergence and provide more arguments in support of it.<sup>14</sup> They introduced the concept of complementarity in the corporate governance related legal systems. The various corporate laws in any country are complementary and consistent with each other. So, any changes in one law will seriously affect the other one. In addition to the switching costs, they affirm the idea that the lovely achievable maximum differs from the global maximum, i.e. “local maximum trap story”. This local maximum could resemble a dead end street for the firm and could obstruct the way to the most efficient system. Due to the pressure of globalization, companies would in panic aspire for the local optimum. Consequently, this would be discouraging the harmonization.

The second main reason quoted by the researchers is that no corporate governance system is proven to be very effective in all circumstances. Even the Anglo-American corporate governance system has its own flaws which are evident from scandals such as Enron and WorldCom.

The third set of researchers takes the middle path. Their perspective is referred to as “functional convergence” by Gilson.<sup>15</sup> He classified the corporate governance convergence into three categories. The first one is the functional convergence which occurs when institutions are flexible enough to respond to demands by market participants without altering the institutions’ formal characteristics. The second one is the formal convergence which occurs when a legislative action to alter the basic structure of the existing governance institutions forces the adoption of best practices. Finally, the contractual convergence occurs when companies change their own corporate governance institutions and lack flexibility to respond with a formal change. Gilson suggests a possible emergence of

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<sup>14</sup> SCHMIDT, R. H. and G. SPINDLER. Path Dependence, Corporate Governance and Complementarity. *International Finance*. 2002, vol. 5, no. 3, pp. 311-333. ISSN 1468-2362.

<sup>15</sup> GILSON, R. J. Globalizing Corporate Governance: Convergence of Form and Function. *The American Journal of Comparative Law*. 2001, vol. 49, no. 2, pp. 329-357. ISSN 0002-919X.

a globally accepted corporate governance system that is relatively uniform in function terms, despite persisting formal differences. An example of functional convergence is the creation of new exchanges in Europe which give investors the protection that the law does not provide.

### **Corporate Structure in China**

The mainland China which is now known as the People's Republic of China (PRC) came under the rule of the Communist regime in 1949 and adopted a state-dominated economic model. The state-owned enterprises (SOE) were the only allowed business entities. State ownership was considered the most efficient form of public ownership to achieve the goal of socialism. The concept of wealth creation for the investor was not considered the primary responsibility to the SOEs. In the state-dominated planned economy, the primary responsibility of SOEs was to fulfill the production plans of the government, rather than to enhance profits for the state investor. In fact, the terms "corporate" or "legal person" were non-existent in China during the period 1950 – 1984. Instead, the SOEs were simply referred to as factories. The SOEs, in turn, depended solely on the state for their funding needs. The other most important stakeholders, i.e. employees, were also fully protected once they joined the SOEs as they will be provided job protection, housing, medical treatment, and pension. SOEs were, thus, both production units and social security units.

However, things changed after the paramount leader Deng Xiaoping took over the reins in the late 1970s. The government realized the need to encourage entrepreneurial spirit to enable the economy to compete in the global market. Hence, individuals and families were permitted to start their own ventures; this resulted in small entrepreneurs emerging, first in the rural areas and later in the cities. In 1978, 100 % of new business investment in China was from the government. This figure was reduced to 82 % in 1980 and further reduced to 66 % in 1985 because of the investments by the new entrepreneurs.

Still in absolute numbers, the business and industry was dominated by SOEs. The government has realized that the SOEs are sucking money without being efficient. So it started reforming the SOEs to make them responsible for their own gains and losses in the market. In the official language, "SOEs should become legal persons that enjoy full management authority and full responsibility for their own profits and losses." Hence, SOE law was enacted in 1988. It gave the freedom to the SOEs at the op-

erational level. As per the provisions of the law, the SOEs need to sign a contract with the respective government agencies. According to the contract, the CEOs, who are selected through a competitive process and act as the legal principle of contracting system, are required to “lock the minimum amount of profit for the SOEs to pay to the state”, and entitle SOEs “to keep the remaining profit”, while liable for paying the fixed amount to the state, even if SOEs have not made satisfactory profit. In the same year, the government enacted the Bankruptcy Law to facilitate the bankruptcies of the SOEs.<sup>16</sup>

Further, the government supported the opening up of two stock exchanges. In 1990 and 1991, China’s two stock exchanges – the Shanghai and Shenzhen Stock Exchanges were opened respectively. Initially, there were only ten companies which were listed on these stock exchanges. The SOEs were encouraged to raise funds from the public market to meet the investment requirements after taking approval from the relevant ministries. Listed companies’ capital structure can consist of state owned shares, legal person shares, A-shares, B-shares, H-shares, and foreign investment shares.

These reforms helped to reduce the intervention of the government in business entities and the performances of SOEs have improved significantly. Still, they were not up to the expectations. The reforms reduced the domination of banks, particularly state-owned institutions which had often been directed to lend funds to inefficient state enterprises, resulting in non-performing loans.

After a long debate and processing, the government has enacted the PRC Company Law in December 1993, effective from July 1<sup>st</sup>, 1994. The Company Law is intended to regulate corporate structures and activities and to protect commercial interests of the companies, their shareholders, and creditors. Two types of companies are stipulated under the Company Law: closely held companies and publicly held companies.<sup>17</sup>

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<sup>16</sup> SCHIPANI, C. A. and J. LIU. Corporate Governance in China: Then and Now. *Columbia Business Law Review*. 2002, vol. 2002, no. 1, pp. 1-69.

<sup>17</sup> TAI, K. and C. R. WONG. Corporate Governance in China. In: *The International Center for Finance at the Yale School of Management* [online]. 2003-11-17 [cit. 2014-11-10]. Available at: <http://bb.shufe.edu.cn/bbcswebdav/institution/%E7%BB%8F%E6%B5%8E%E5%AD%A6%E9%99%A2/teacherweb/2005000087/bizecon/notes/governance/corporate%20governance%20in%20china.htm>.



The PRC Company Law requires companies to form three statutory and indispensable corporate governing bodies as given below:<sup>18</sup>

- ✚ the shareholders, acting as a body at the general meetings;
- ✚ the board of directors; and
- ✚ the board of supervisors.

Besides, it also introduced two statutory corporate positions – the chairman of board of directors and the chief executive officer. It also articulates the responsibilities, rights, and liabilities of the above-mentioned governing bodies. The relationship between the board of directors and the board of supervisors is not totally similar to that of other two-tier board systems. In countries like Germany, the supervisory board oversees the board of directors, and the board of supervisors can appoint or dismiss the members of the board of directors. But in China there is no hierarchical relation between the board of directors and the board of supervisors and both directors and supervisors are appointed by, and may be dismissed by the shareholders.<sup>19</sup> The Company Law of the People's Republic of China has certain unique aspects, such as the requirements for minimum registered capital, fixed office space, and certain legal representative's. The PRC Company Law has been amended in 1999 to fine-tune further.<sup>20</sup>

China passed Securities Law in 1998 to regulate the financial market. The law stipulates that the Regulatory Organization under the State Council is the central regulator for the China's capital markets. The Chinese government has also come out with other laws to govern the corporate entities; the prominent ones being the Contract Law 1999 and the Trust Law 2001. The regulatory system was also put in place in the 1990s to ensure better corporate governance practices.<sup>21</sup>

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<sup>18</sup> SCHIPANI, C. A. and J. LIU. Corporate Governance in China: Then and Now. *Columbia Business Law Review*. 2002, vol. 2002, no. 1, pp. 1-69.

<sup>19</sup> SCHIPANI, C. A. and J. LIU. Corporate Governance in China: Then and Now. *Columbia Business Law Review*. 2002, vol. 2002, no. 1, pp. 1-69.

<sup>20</sup> TAI, K. and C. R. WONG. Corporate Governance in China. In: *The International Center for Finance at the Yale School of Management* [online]. 2003-11-17 [cit. 2014-11-10]. Available at: <http://bb.shufe.edu.cn/bbcswebdav/institution/%E7%BB%8F%E6%B5%8E%E5%AD%A6%E9%99%A2/teacherweb/2005000087/bizecon/notes/governance/corporate%20governance%20in%20china.htm>.

<sup>21</sup> TAI, K. and C. R. WONG. Corporate Governance in China. In: *The International Center for Finance at the Yale School of Management* [online]. 2003-11-17 [cit. 2014-11-10]. Available at: <http://bb.shufe.edu.cn/bbcswebdav/institution/%E7%BB%8F%E6%B5%8E%E5%AD%A6%E9%99%A2/teacherweb/2005000087/bizecon/notes/governance/corporate%20governance%20in%20china.htm>.

The People's Bank of China (PBOC) was the regulator for the China's financial sector since 1983. Besides regulating the financial markets, the Bank also acted as administrator of the country's monetary policy. But, in order to bring in more effectiveness, in 2003 the regulatory functions of PBOC were separated and the same were entrusted to a newly formed China Banking Regulatory Commission.

While creating the stock exchanges, China has created the China Securities Regulatory Commission (CSRC) as the securities regulatory body in 1992. The CSRC regulates all securities exchanges and the activities of futures markets in the People's Republic of China.

The CSRC is the executive arm of the State Council Securities Commission which is the highest authority for the capital markets in China. In 2002, the CSRC has come out with a code of Corporate Governance for Listed Companies in China. The code aims to establish solid corporate governance in the stock market listed companies by elevating requirements related to accounting procedures and information disclosure, introducing independent director systems, and tightening the supervision of corporate management.<sup>22</sup>

Accounting standards in China are based on the PRC's Accounting Law and the individual accounting standards. The accounting standards have been developed by the China Accounting Standards Committee which was formed in 1990s and operates under the supervision of the Ministry of Finance. Since the system is new, its accounting standards are still evolving.

### **Convergence of Corporate Governance in China**

Now the question of whether the Chinese corporate governance system is converging towards the Anglo-American model or not needs to be answered. Unlike other nations, China's path dependency was totally different in terms of the meaning for the term corporate governance. In China, there was no need to formally focus on shareholder protection or stakeholder protection as the SOEs were the only form of business entities till the early 1980s. In fact, there was no equivalent of the term "corporate

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<sup>22</sup> RAJAGOPALAN, N. and Y. ZHANG. Corporate Governance Reforms in China and India: Challenges and Opportunities. *Business Horizons*. 2008, vol. 51, no. 1, pp. 55-64. ISSN 0007-6813.

governance” in the Chinese Mandarin language. Only in 1999, the Communist Party adopted the current nomenclature, Farenzhilijegou, which is also more suggestive of administering and supervisory roles. Given this, China did not have much of legacy problems in terms of creating a corporate governance structure. In form, the corporate governance structure is taking a lot from the Anglo-American model. The Code of Corporate of Governance for the Listed Companies in China, issued in 2002, clearly follows the U.S. model.

Similarly, in 2005, China initiated a plan that would eliminate the various share ownership types and make all shares legally tradable A-shares. Having a single type of share for a company is again the Anglo-American model.

The improvement in the corporate governance practices, focusing on improving the shareholders’ wealth in line with the Anglo-American model, is showing tangible effects. China has succeeded in introducing market forces with accompanying financial incentives, with rules driving much of the change. The share of the SOEs in total industrial production has fallen from more than three-fourth in the late 1970s to around one quarter by 2003.<sup>23</sup>

Empirically studies also proved that the Chinese corporate governance systems are moving towards the Anglo-American model. Keister showed that in the late 1990s, the Chinese SOEs preferred borrowing externally from the market over using retained earnings, presumably to avoid relying on resources controlled by the state.<sup>24</sup> This is perfectly in line with practices adopted by the western firms particularly from the Anglo-American countries. Fan et al. found out that many empirically proven characteristics related to CEO turnover in the Anglo-American model are present in the Chinese systems as well.<sup>25</sup>

But, at the same time, some of the practices of the relationship model corporate governance systems prevail also in China. For example, social

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<sup>23</sup> HUA, J., P. MIESING and M. LI. An Empirical Taxonomy of SOE Governance in Transitional China. *Journal of Management and Governance*. 2006, vol. 10, no. 4, pp. 401-433. ISSN 1385-3457.

<sup>24</sup> KEISTER, L. A. Capital Structure in Transition: The Transformation of Financial Strategies in China’s Emerging Economy. *Organization Science*. 2004, vol. 15, no. 2, pp. 145-158. ISSN 1047-7039.

<sup>25</sup> FAN, D. K. K., Ch.-M. LAU and M. YOUND. Is China’s Corporate Governance Beginning to Come of Age? The Case of CEO Turnover. *Pacific-Basin Finance Journal*. 2007, vol. 15, no. 2, pp. 105-120. ISSN 0927-538X.

networks are common in China with its relationship-based culture that gets things done in the absence of institutional constraints. Similarly, China's own culture has its roots also in the development of corporate governance system. Research studies indicate that the traditional Chinese cultural values such as loyalty, guanxi, play an important role in business practices and have very strong influence in the emerging corporate governance structure. Grandori identifies the coordination mechanisms which he calls as combinative, seen in clans, trusts, and networks that dominate the Chinese culture.<sup>26</sup> There are authors who argue that the Anglo-American system of corporate governance will not work in China. There are many reasons quoted for this. For example, Hua et al. argue that the necessary institutional conditions for the shareholders-centered regimes, including the laws of finance and industrial regulation, are still evolving slowly and with great difficulty in China.<sup>27</sup> Hence, the western approaches to corporate governance will be insufficient in the absence of corresponding institutional and cultural changes. Mallin and Rong also take similar line and comment that any system of corporate governance that develops in China is likely to embody the special role of the state and contain certain idiosyncratic cultural aspects while taking on certain characteristics of the Anglo-Saxon corporate governance model.<sup>28</sup>

Even though the code of corporate governance is in line with the U.S. model, there are conflicting views on how well they have been accepted or implemented by firms and there are also conflicting views on whether they have had good effect on firms' performance. Empirically studies also suggest that the Chinese corporate governance systems are functionally different from that of the U.S. The study by Morck et al. shows that there is no association between the stock return and CEO's pay (the emphasis on practice).<sup>29</sup> This is because the stock returns tend to move together in

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<sup>26</sup> GRANDORI, A. Governance Structures, Coordination Mechanisms and Cognitive Models. *Journal of Management and Governance*. 1997, vol. 1, no. 1, pp. 29-47. ISSN 1385-3457.

<sup>27</sup> HUA, J., P. MIESING and M. LI. An Empirical Taxonomy of SOE Governance in Transitional China. *Journal of Management and Governance*. 2006, vol. 10, no. 4, pp. 401-433. ISSN 1385-3457.

<sup>28</sup> MALLIN, Ch. and X. RONG. The Development of Corporate Governance in China. *Journal of Contemporary China*. 1998, vol. 7, no. 17, pp. 33-42. ISSN 1067-0564.

<sup>29</sup> MORCK, R., B. YEUNG and W. YU. The Information Content of Stock Markets: Why Do Emerging Markets Have Synchronous Stock Price Movements?. *Journal of Financial Economics*. 2000, vol. 58, no. 1-2, pp. 215-260. ISSN 0304-405X; and BAI, Ch.-E., Q. LIU, J. LU, F. M. SONG and J. ZHANG. Corporate Governance and Market Valuation in China. *Journal of Comparative Economics*. 2004, vol. 32, no. 4, pp. 599-616. ISSN 0147-5967.

China reflecting marketwise factors; firm-specific factors have less influence on stock prices. Firms are reluctant to reward CEOs on the basis of stock returns and instead use the accounting-based measures of performance.

## Conclusion

The above-mentioned discussions indicate that China is adopting the Anglo-American model of the corporate governance system. But the researchers differ in their views related to the question that the convergence is happening at the functional level. In our opinion this is in contrast to the view of Gilson who argues that functional convergence will happen faster than the convergence at the form level. This is because the effect of path dependence is low in China, as the concept of corporations with profit motive as it is known in the western world did not exist in China before the 1980s. The presented paper offers further scope for research as one can compare the corporate governance practices of the People's Republic of China with the different corporate governance systems practiced in Hong Kong and Taiwan.

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Debabrata Chatterjee, MBA, Ph.D. Candidate

Department of Management  
Birla Institute of Technology, Mesra  
Mesra, Ranchi  
Jharkhand 835 215  
India  
debu\_nhpc@yahoo.co.in